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SUBJECT: U.S.-JAPAN INVESTMENT WORKING GROUP APRIL 2007 SESSION

SENSITIVE BUT UNCLASSIFIED - PROTECT ACCORDINGLY

Ref: A) 06 Tokyo 6584
B) Tokyo 454

¶1. (SBU) Summary: The second session of the U.S.-Japan Investment Working Group (IWG) for FY-2007 took place on April 13 via digital videoconference (DVC). The IWG reviewed progress on all agenda items in advance of the annual report to leaders in June. Both sides expressed satisfaction with the results of February's information exchange on investment chapters in bilateral agreements, which concluded that the United States and Japan took similar approaches to negotiating investment texts. The IWG agreed to reach out to the private sector for its views on the investment climate in both countries, possibly as early as May. On specific U.S. concerns, METI announced the April 13 promulgation of final tax deferral rules for triangular mergers. Both sides agreed the market would be the final judge of the effectiveness of the new rules in facilitating new investment flows. METI rejected a U.S. proposal to conduct a formal study of the impact of the tax rules before the end of 2008 but promised it would continue to "monitor" Japan's M&A climate. On educational services, MEXT reported it had issued new regulations which expand nationwide existing special zone rules that allow universities to lease, not own, their physical facilities. This should facilitate market entry of new foreign universities by reducing start-up costs. There were no significant developments on labor mobility issues. Ambassador Michael Michalak headed the U.S. delegation and Noriyuki Mita, Director of the Americas Division lead the Japanese side. End Summary.

Experts Review of Investment Chapters

¶2. (SBU) During an April 13 DVC, the U.S.-Japan Investment Working Group reviewed the results of the February meeting of the Investment Experts Sub-committee which conducted a comparison study of the investment chapters of both countries' bilateral investment treaties (BITs) and free trade agreements (FTAs). The experts concluded that the United States and Japan take similar approaches to negotiating investment texts, putting a priority on guaranteeing national treatment, obtaining most favored nation status and covering the full lifecycle of the investment. Both sides also seek a guarantee of "fair and equitable treatment" as the minimum standard for investment protection, prohibit specific performance requirements and take a "negative list" approach to restricted sectors. USTR's Director for Investment and Services observed that Japan's views on international investment issues are closer to the U.S.' positions

than any other country with which the U.S. has negotiated an investment treaty or chapter. In the U.S.' experience, most countries with which it negotiates are negotiating a high quality agreement for the first time.

13. (SBU) Where the U.S. and Japanese approaches most differ is in dispute settlement, with U.S. agreements generally having wider coverage, allowing dispute mechanisms to handle issues related to investment authorization and changes to the conditions for investment approval. Dispute settlement procedures in Japanese agreements, by contrast, generally cover only disputes arising from breach of the agreement itself. Japan's acting IWG co-chair, METI's Director of the Americas Division, noted the particular relevance of the broad U.S.-style coverage for future investment agreements with China, which often changes investment rules after the fact. Other differences between existing U.S. and Japanese texts involve exceptions to the agreement. U.S. agreements generally allow only limited exceptions while Japan's agreements include exceptions based on the OECD's draft Multilateral Agreement on Investment or for national security concerns.

14. (SBU) Japan also commended the United States negotiators for their extensive "due diligence" work prior to entering BIT/FTA negotiations, including internal discussions through the Trade Policy Review Mechanism and external consultations with both the Congress and the private sector.

15. (SBU) The IWG also discussed future cooperation in multilateral investment fora. The two sides agreed to work together to encourage APEC members to make greater use of the OECD's Policy Framework for Investment (PFI) matrix as a tool to analyze and improve individual member's investment regimes. Japan also proposed, and the United States agreed, to expand bilateral cooperation in multilateral and plurilateral fora, such as the G-8 where Germany recently proposed

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new language related to investment protection. But both sides agreed it was not practical to try to advance investment issues multilaterally through the WTO at the present time.

16. (SBU) Japan requested a briefing on the investment chapter of the recently-concluded U.S.-Korea FTA (KORUS) but the U.S. side declined noting that a final KORUS text is not yet publicly available. The U.S. side did note, however, that the KORUS investment chapter was very similar to investment chapters in other U.S. FTAs.

U.S. Concerns

17. (SBU) Triangular Mergers: The U.S. expressed appreciation for Japan's work on final implementation of the triangular merger provisions of the Company Law, which take effect May 1. In the U.S.' view, these provisions will be key to achieving the Prime Minister's goal of raising Japan's stock of foreign direct investment (FDI). However, the U.S. side expressed concern that proposed tax deferral rules could reduce the amount of FDI Japan might otherwise receive as a result of the new law. The U.S. intends to closely track how the new tax rules operate in practice to determine if they are impeding use of the triangular merger provisions. It asked the Japanese government to consider undertaking its own formal review of the new rules by the end of 2008.

18. (SBU) METI's Director of Trade and Investment Facilitation responded that because the government considers the new tax rules to be permanent the government would not do a formal review of their impact but METI will regularly monitor the overall condition of Japan's M&A regime going forward. The government's policy of encouraging inward FDI remains unchanged. Both sides agreed to continue joint efforts to encourage increased FDI into Japan.

19. (SBU) On a related issue, the U.S. side reported that it had examined MOJ's draft rules for enhanced disclosure requirements by firms involved in triangular mergers and found nothing objectionable. MOJ responded that it had received a number of

formal comments on the new rules. Based on those generally positive comments, MOJ was now making technical modifications to the draft rules and expected only minor changes in the final regulations.

¶10. (SBU) Defensive Measures: The U.S. side asked whether METI or the Tokyo Stock Exchange had undertaken a study of the impact of the increasing numbers of defensive measures adopted by Japanese companies since the 2005 Company Law took effect in May 2006. METI's Director of Industrial Organizations responded that, as of March 31, 2007, 220 Japanese companies had introduced changes to their by-laws to allow some form of defensive measures to hostile takeover bids. With the approach of the season for shareholders' meetings in June, it was likely additional firms would adopt such measures. But, METI noted, since few companies had actually used these measures yet, there was not enough real world experience to draw valid conclusions as to the impact on the market.

¶11. (SBU) The U.S. requested an explanation of the recent reconstitution of METI's Corporate Value Study Group which met for the first time in more than a year on April 6. According to METI's Director of Industrial Organizations the study group discussed a number of recent developments in Japan's M&A market, including the types of defensive measures firm have adopted, the use of different classes of stock to improve corporate governance and the need for a consistent approach toward delisting troubled companies but did not reach any formal conclusions.

¶12. (SBU) Educational Services: Ministry of Education, Culture, Sports, Science and Technology (MEXT) reported that, since the last IWG meeting (Ref A), MEXT officials have met several times with representatives of Temple University Japan (TUJ) to discuss the criteria TUJ would have to meet to receive legal status as a Japanese educational institution (gakko hojin). Informal communications with TUJ by phone and e-mail are continuing but, contrary to press reports, TUJ has not yet submitted a formal application for gakko hojin status.

¶13. (SBU) MEXT also reported the result of its request for public comment on a proposal to drop the requirement that universities and other institutions of higher education must own their own land and facilities. MEXT reported it had received a number of comments both

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pro and con and the Ministry had issued final regulations extending the rules, which previously were limited to special zones for structural reform, nationwide as of April 1. The U.S. side expressed hope that the new rules would lower entry costs of new foreign educational institutions entering the Japanese market.

¶14. (SBU) Labor Issues: Ministry of Health, Labor and Welfare (MHLW) reported on the government's efforts to expand rules governing white collar overtime exemption. The ruling party originally planned to introduce legislation on this subject in the current Diet session but according to MHLW had been "unable to gain the understanding of the Japanese people" for the proposal and withdrew it. However, MHLW said the government will continue to look for ways to promote greater flexibility in the workplace.

¶15. (SBU) On defined contribution pension plans, MHLW has undertaken a study of the current system, as required by legislation. Based on that study, the Ministry is now considering changes to the law including an increase in contribution limits for defined contribution plans, as requested by a number of domestic and foreign firms. On the issue of monetary settlements for disputed dismissals, MHLW said the issue had been too divisive to include in the new Labor Contracts Law, but that study of the issue continues.

Study Group on the International Investment Climate in a Globalized Economy

¶16. (SBU) The U.S. requested a report on the outcome of discussion within the METI Study Group on International Investment Climate in a Globalized Economy which METI established in December 2006 to recommend changes to the Foreign Exchange Control Law (Ref B) restrictions on foreign investment for national security reasons.

According to METI, the group has met several times but has made no final recommendations. METI assured the IWG that the objective of the study was to make Japan's regulations consistent with other countries' rules and, whatever the group recommended, METI would "try very hard to ensure the rules do not impede inward foreign direct investment." The U.S. welcomed further discussion of the study group's recommendations at a future IWG meeting.

Japan Concerns

¶17. (SBU) Visas: Japan reiterated its concerns regarding U.S. visa policy, specifically its request for resumption of domestic revalidation of work visas, expanding the ability to revalidate such visas in third countries, consideration of the extension of the validity of such visas and expanding the number of visa-issuing posts in Japan. The United States responded it was currently making technical preparations for resumption of visa services at U.S. Consulate Fukuoka under a similar process to that used at U.S. Consulate Sapporo. There were no new developments in other areas of concern.

¶18. (SBU) Secure Trade: The United States and Japan have agreed to discuss secure trade issues in a joint task force as part of the sub-cabinet process. The task force held its first meeting in early March. Japan said it found the March meeting very fruitful and agreed to continue discussion of secure trade issues in that forum. But it asked to retain the option of raising these issues at future IWG meetings if there were specific issues relevant to the IWG's work.

¶19. (SBU) Exon-Florio: Japan asked for an update on recent moves by the Congress to amend the Exon Florio amendment. Embassy's Financial Attach reported that the House of Representatives passed the National Security Foreign Investment Reform and Strengthened Transparency Act of 2007 on February 28, 2007 by unanimous vote. The Senate plans to take up the bill soon. As the legislative process continues, the Administration intended to work with the House and Senate to update the CFIUS process based upon the following principles: further integration of national and homeland security interests in a post 9/11 environment; continuing to welcome foreign investments in the United States; and preserving what works about CFIUS, while making improvements where needed and maintaining the integrity of the decision-making process. The U.S. further noted that in addressing potential threats to our national security that may be posed by a specific transaction, the U.S. has taken great care to avoid unnecessary impediments to foreign investment.

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¶20. (SBU) Japan warmly welcomed the announcement and briefing by the Commerce's Office of Japan on the USG's new "Invest in America" Initiative.

Future Program of Work

¶21. (SBU) The IWG agreed to complete its annual report to leaders in time for submission at the annual G-8 summit in June. Japan requested that the report contain strong wording on both countries' continued commitment to promoting FDI and combating "investment protectionism." The two sides also agreed to highlight the expert review of investment chapters and agreements in this year's report.

¶22. (U) METI announced that the next JETRO Investment Outreach Seminar for 2007 will be held in Osaka on September 12. JETRO has invited the participation by a number of U.S. Governors who will be visiting Japan at that time to participate for the Japan-Midwest Governors Forum.

¶23. (SBU) The IWG agreed to continue its examination of investment climate in both countries by reaching out to the private sector starting with international business chambers in both countries. One possibility is to begin this process during the next scheduled visit of the U.S. IWG co-chair to Japan the end of May. Another possibility is utilizing the November 2007 meeting of the U.S.-Japan

Business Council in Washington. USTR agreed to reach out to that agency's Investment Trade Advisory Committee (ITAC) to discuss ways the U.S. and Japan can effectively cooperate in promoting investment in multilateral economic fora. The U.S. Embassy agreed to meet with the former head of the Industrial Reconstruction Corporation of Japan (IRCJ) to see if the IWG can learn from IRCJ's experience in promoting corporate restructuring and investment in distressed assets.

Delegation Lists

124. (U) U.S. Participants:

In Washington:

Ambassador Michael Michalak, U.S. Senior Official for APEC,
Department of State
Mr. Eric Kennedy, Office of Japan, Department of Commerce
Ms. Jessica Webster, Chief, Economic Unit, Office of Japanese
Affairs, Department of State
Mr. David Weiner, Office of Services and Investment, USTR
Mr. Robert Winship, Economic Officer, Office of Japanese Affairs,
Department of State.

In Tokyo:

Mr. Daniel Fantozzi, Economic Counselor, U.S. Embassy
Mr. Christopher Wurzel, First Secretary, Economic Section
Ms. Maureen Grewe, Financial Attach
Mr. David DiGiovanna, First Secretary, Economic Section
Mr. Robert Thommen, U.S. Customs and Border Protection Attach
Mr. Marc Dillard, First Secretary, Economic Section
Mr. Satoshi Hattori, Economic Specialist, U.S. Embassy
Mr. Ritsu Yamashiro, Economic Specialist, U.S. Embassy

125. (U) Japanese Participants:

In Tokyo:

Ministry of Economy, Trade and Industry:

Mr. Noriyuki Mita, Director, Americas Division, Trade Policy Bureau

Mr. Shinichi Kihara, Deputy-Director, Americas Division, Trade
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Mr. Takeo Ijuin, Deputy-Director, Americas Division, Trade Policy
Bureau
Ms. Yuko Chikazoe, Chief, Americas Division, Trade Policy Bureau
Mr. Kenji Goto, Director, Industrial Organization Division, Economic
and Industrial Policy Bureau
Mr. Masakazu Ichikawa, Director, Trade Finance and Economic
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Mr. Keiichi Kawakami, Director, Trade and Investment Facilitation
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Ministry of Foreign Affairs:

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Mr. Junichi Takahashi, Second North America Division,
North American Affairs Bureau

Ministry of Justice:

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Mr. Tsuyoshi Shimizu, Attorney, Civil Affairs Bureau
Mr. Takeshi Komatsu, Attorney, Civil Affairs Bureau

Ministry of Education, Culture, Sports, Science and Technology:

Mr. Kazuhiro Kotani, Deputy-Director, Higher Education Policy
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Ms. Akiko Tozawa, Official, Office of Director-General for
International Affairs

Ministry of Health, Labor and Welfare:

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Bureau

Ms. Kosaku Sano, Chief, Private Employment Service Division,
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Mr. Chiaki Miyazaki, Chief of Planning Section, Corporate Pension
and National Pension Fund Division
Mr. Tadaaki Hanatani, Assistant Director, International Affairs
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In Washington:

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DONOVAN